In the United States Bankruptcy Court
for the
Southern District of Georgia
Savannah Division

In the matter of:	)	
	)	Chapter 11 Case
KEY AIRLINES, INC.	)	
	)	Number 93-40226
Debtor	)	

MEMORANDUM AND ORDER ON MOTION TO CONVERT

The hearing on the above-captioned Motion to Convert filed by WorldCorp, Inc., and Classic Travel, Inc., d/b/a Fling Vacations, was heard on September 30, 1993. After consideration of all of the evidence and applicable authorities I make the following Findings of Fact and Conclusions of Law.

Procedural History

Debtor's case was filed February 8, 1993. Pursuant to the provisions of Title 11 Debtor has remained in possession since filing and operated its business actively for a period of approximately two months. Thereafter in May, 1993, the Debtor ceased active flight operations but continued to maintain an office, a limited number of employees, and to conduct some administrative business. In accordance with the requirements of the Code the Debtor has filed periodic reports with the Office of the United States Trustee setting forth the results of its business operations.[1] The most recent report filed covers the period ending June 30, 1993, and reveals a year-to-date loss of $491,533.00.

Debtor, throughout the pendency of this case, has asserted that in order for a reorganization plan to succeed it would be necessary for new capital to be invested in this business. Beginning in late May or early June, Debtor asserted in pleadings filed in this court and in arguments presented in open court that it was negotiating the possible sale of Key Airlines and its assets to a company known as Tower International.

This Motion to Convert was filed on May 17, 1993, and initially set for a hearing on June 28, 1993. On June 16, 1993, Debtor filed a Motion for a Continuance of the hearing on the Motion to Convert and asserted that Debtor's reorganization plan was premised on an "offer to purchase the Debtor made by Tower International, Inc.," a copy of which is attached as Exhibit "A". Based on that and other allegations the Debtor requested that the June 28th hearing be continued for an additional thirty days. The attachment to that Motion was a two and a half page letter dated June 7, 1993, from William L. Weiss to Debtor's counsel outlining that Tower International, Inc., was "prepared to enter into a formal agreement for the acquisition" of Debtor subject to a number of terms and conditions. One of the conditions reserved to Tower "thirty days to perform a businessman's due diligence analysis" of the Debtor.

On June 18th Debtor filed an emergency motion seeking multiple relief including permission to obtain post-petition financing. That motion referred to the Tower agreement (Mr. Weiss' June 7th letter) and asked the court for permission to utilize Debtor's cash collateral and enter into the financing agreement contemplated in the Tower letter of intent which would provide up to $500,000.00 in post-petition financing. The court assigned a hearing on Debtor's emergency motion seeking post-petition financing from Tower for June 28, 1993, the same date as the initial hearing for the Motion to Convert.

At the date and time scheduled for the hearing on the Motion to Convert and the Motion for Approval of post-petition financing, Debtor announced to the court that an interim agreement had been reached whereby the company would be operated during the due diligence period with some financial assistance by Tower International. Debtor contemplated that the specific terms of the proposed sale would continue to be negotiated and finalized and moved that the Motions be continued. Parties in interest at that hearing asserted no vigorous opposition to the continuance but reserved the right to object to the terms of any proposed sale. The court thereafter entered an order approving the interim arrangement and setting the post-petition financing hearing for July 21, 1993. Notice of a continued hearing on the Motion to Convert was also given for July 21, 1993.

When the continued Motion to Convert was called for hearing on July 21st, Movant's counsel requested the court to continue it for an additional sixty days under an agreement whereby Tower and the Debtor would provide funds to cover certain limited but accruing administrative expenses. The parties contemplated that the contract between the Debtor and Tower would be finalized and noticed to all parties in interest for a hearing whether to approve or reject the possible sale of the Debtor to Tower by the end of the sixty day continuance. On July 27th an interim order on the Motion to Convert was entered continuing the hearing for the sixty day period and incorporating the limitation on the accrual of operating expenses during the interim period. On August 5, 1993, a notice of the continued hearing on the Motion to Convert was issued by the Clerk's Office setting the hearing for September 23rd at 10:00 a.m. Subsequently that hearing was rescheduled for September 10, 1993.

On August 24, 1993, Classic Travel, Inc., d/b/a Fling Vacations, filed a Motion for Contempt alleging that certain funds had been spent in violation of the court's July 27, 1993, order. A hearing was conducted on August 30, 1993, during the course of which, Movant's counsel orally moved the court to consider the appointment of an examiner in view of the alleged improper handling of some of the funds. Counsel for the Debtor and counsel for Savannah Aviation Group, Inc., the sole shareholder, argued that any appointment of an examiner in this case would be counterproductive and argued that the ongoing negotiations with Tower held forth the only realistic prospect of reorganization of the Debtor. The court declined to appoint an examiner at that time.

Thereafter on September 9, 1993, Debtor filed a Motion for Use, Sale or Lease of Property of the Estate asserting that Debtor had entered into an agreement for the acquisition of the company with Tower International, Inc., a copy of which was attached to the Motion. The court scheduled a hearing to consider that Motion for September 30, 1993, at 10:00 a.m. On the following day, the third continued hearing on the Motion to Convert came on for a hearing. The Debtor moved that the hearing on the Motion to Convert be continued further because of the pendency of the Tower agreement attached to its motion filed the previous day. Movant objected to the further continuance based on its cursory review of the agreement believing that it lacked sufficient

[1] The Debtor's operating reports for the months of July and August are now due and have not been filed with the Office of the United States Trustee as required by the Code and the Rules.

benefit to the estate to form the basis of a further continuance of the Motion to Convert. Because the potential benefit of the agreement was a key element of Debtor's defense to the Motion to Convert, the court took a recess and asked all parties in interest to review the contract and be prepared to argue its merits as an aid to my decision whether to hear the Motion to Convert at that time or to continue it further. After the recess Movant's counsel outlined in detail a number of what it believed to be irreversible deficiencies in the agreement. Debtor's response was that a number of the objections were technical in nature and others could be resolved through further negotiations between the Debtor and Tower. After full consideration of the objections and the Debtor's response I agreed to continue the hearing on the Motion to Convert until September 30th, the same date when the Motion to Consider Approval of the Sale of the Debtor had previously been scheduled for a hearing.

On September 30th the hearing on the Motion to approve the proposed sale was conducted and objections were raised by several parties in interest asserting that the proposed sale was one-sided, would guarantee no benefit to the estate and provided enumerable escape clauses through which Tower could relieve itself of any financial obligation to the Debtor. In response Tower's counsel and principal revealed that there were certain provisions of the agreement which Tower would be willing to waive and other terms which it would be willing to modify. However, as of the September 30th hearing there had been no modification of the agreement in response to the September 10th hearing and the objections raised then. After consideration of the evidence I announced that I would enter an order denying the Debtor's Motion to Approve the Sale inasmuch as the agreement filed in court was not in a form that could be approved and because it was clear that the parties intended to negotiate further and present a new agreement.

FINDINGS OF FACT

This Chapter 11 case was filed on February 8, 1993, at a time when the Debtor airline was actively operating charter flights between the United States and various destinations in the Caribbean and Mexico. By June, the Debtor was no longer flying (Fling Exhibit 1). Its flight certificates from the Federal Aviation Administration ("FAA") and the Department of Transportation ("DOT") are currently in a suspended status. (Transcript of September 30th hearing at page 65).

For the six month period ended June 30, 1993, the Debtor reported an operating loss in excess of $491,533.31. (Id.; Transcript page 56). The actual loss was greater. The Debtor's reports to the United States Trustee include no post-petition expense figures for the lease of aircraft from Irish Aerospace and Air Tara. (Transcript page 56). That expense should total approximately $550,000.00 ($137,000.00 per aircraft per month) for the sixty day period that the Debtor used those planes, absent any setoff or counterclaim of the Debtor. Id.

The Debtor's operating reports also reflect an increase in payables from $0.00 on February 28, 1993, to $231,917.21 (exclusive of payroll payables) as of June 30, 1993. (Fling Exhibits 1 and 3). This additional accrued liability represents a corresponding additional loss to the Debtor. The reports also overstate operating income during the post-petition period because income includes post-petition collection of pre-petition receivables. (Transcript page 58).

At the outset of this case, the Debtor employed 186 full-time and 155 part-time employees. (Fling Exhibit 3). The Debtor now has two employees on the payroll and is informally accruing, but not paying, payroll expense for two additional employees. (Transcript pages 59-60). The Debtor has reported no operating income since April and has been paying a portion of its June-September administrative expenses out of cash in the bank which exists primarily as the result of a settlement with WorldCorp. (Transcript page 110).

The Debtor concedes that without an infusion of capital or other financial assistance in excess of $1 million, it will not be able to fly again. (Transcript pages 60-63). The Debtor currently has only $138,000.00 in the bank.

The Debtor continues to express hope that Tower International, Inc., will come forward to bail it out. In fact, the Debtor concedes that absent Tower's intervention, it will not fly again. (Transcript page 60). Tower has made several proposals to buy the stock of Key from Key's parent corporation, Savannah Aviation Group ("SAG"). The most recent proposal by Tower was rejected by this court on September 30th for a myriad of reasons including those voiced by objecting creditors. (Transcript page 51). The Tower offer expired by its own terms on September 30th.

One basis for creditor objections to the Tower proposal was that Tower proposed to abandon preferential and fraudulent transfer claims which Key may have against SAG, its principals and other third parties. (Transcript page 90). SAG acquired the stock of Key on October 23, 1992. (Transcript page 73). One week after the closing, $700,000.00 was transferred from Key to AVICA, a corporation wholly-owned by a principal of SAG. From there, the money was disbursed to various parties as shown in a report by the Debtor to the United States Trustee. (Fling Exhibit 2). At least a portion of that money appears to have been used to repay debts of SAG to third parties. (Id.; Transcript pages 74-75).

It also appears that SAG committed to put $3 million into Key before April 30, 1993, and has not done so. (Transcript pages 75-76). It apparently cannot or will not do so now. (Transcript page 78). It is abundantly clear that Key will not move against SAG or its principals if it remains a debtor-in-possession.

Testimony revealed that in order to engage in flight operations the Debtor must hold certificates from the FAA and the DOT. Apparently the operating specifications issued by the FAA are operable at present but the economic authority which must be issued by the DOT in order for an airline to fly are currently in a state of suspension. It was estimated that as much as a $1 million investment would be required in order to provide the assurance to the DOT necessary to have the Debtor's economic authority renewed. In order to maintain its authority the Debtor must have a minimum of four and more likely five employees covering certain mandated job descriptions at a cost of approximately $25,000.00 per month. The still-anticipated agreement contemplates that aircraft would be supplied at a nominal figure to Key Airlines by an entity known as ECA which would also provide flight crews and assume the cost of crew training and other obligations. Key, which would be required to have certificates permitting it to fly, would utilize its certificates, together with the ECA or Tower aircraft and crews, in order to resume flight operations and would receive compensation for services rendered. It is contemplated that ECA and Tower would assume all financial risks of the renewed operations and that Key would incur no further expenses, other than its obligation to pay its five mandated employees and operation of its operations and administrative facilities. While the ability of ECA to perform was unquestioned by Mr. Melamid, the principal of Tower International, no evidence was introduced as to ECA's financial wherewithal or ability to perform, or of Tower's.

I conclude, based on all the evidence, that the Tower contract is at best illusory. While there is no question that the principals involved in the negotiations have proceeded in a good faith belief that they could consummate a deal, they have been unable to do so over a period of four months with full knowledge that a motion to convert the case to a Chapter 7 liquidation was pending. Under that threat, presumably great urgency would attach to the parties' negotiations and yet they have been unable to agree on the terms of a written contract that could be approved by the court. In addition the essential objections to the contract, which was the subject of the September 30th hearing, were enunciated by the creditors at the September 10th hearing and no written

amendment or other final documents were entered into by the parties prior to September 30th.[2]

[2] On October 4, 1993, an amended, but incomplete, contract was filed with the court. Upon brief review it appears to contain many of the same infirmities as the earlier contract and as a result I will decide this case based on the record as of September 30th since the terms of this agreement are not before the creditors and to do so would require additional delay. For a non-exhaustive list of provisions in the contract which evidence its onesidedness in favor of Tower International and its many escape clauses which make the contract more illusory than real, see the following:

> (a) Paragraph "K", page 7, which provides Tower has the absolute right to terminate the agreement if administrative expenses during the pendency of the Chapter 11 exceed $500,000.00;
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> (b) Paragraph "D", page 10, conditioning Tower's obligation to fund its post-petition financing obligations on administrative expenses not exceeding the sum of $500,000.00;
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> (c) Paragraph "B", page 11, granting Tower the unilateral option to terminate the agreement if Debtor fails to obtain court approval of the subject agreement by October 28, 1993, a deadline which cannot be met given the notice requirements of Bankruptcy Rule 2002 and the minimal time in which any party in interest would have to appeal the court's decision set forth in Bankruptcy Rule 8002;
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> (d) Paragraph "D", page 11, which requires Debtor to obtain a final order of confirmation by March 31, 1994, "in form and substance satisfactory to purchaser" thus granting the purchaser the unilateral right to pass on it as "satisfactory" regardless of whether the Court has confirmed it;
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> (e) Paragraph "E", page 11, failure to obtain by November 15, 1993, DOT and FAA certificates which were conceded in testimony before me to be incapable of being obtained in a period less than sixty days;
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> (f) Paragraph "8", page 13, providing that if Tower terminates the contract "for any reason other

CONCLUSIONS OF LAW

11 U.S.C. Section 1112 provides in relevant part as follows:

> (b) Except as provided in subsection (c) of this section, on request of a party in interest or the United States trustee, and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause, including--
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> (1) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation;
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> (2) inability to effectuate a plan;
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> (3) unreasonable delay by the debtor that is prejudicial to creditors;
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> (4) failure to propose a plan under section 1121 of this title within any time fixed by the court;

The Debtor has lost more than $1 million during this case. The Debtor currently has no operating income and no reasonable prospect of generating any operating income. With the ongoing expense of employees who must be on the payroll to satisfy the FAA, the estate will inevitably diminish. (Transcript page 59).[3]

Absent setoffs and counterclaims, the Debtor owes post-petition payables in excess of $750,000.00. I assume, without ruling, that the majority of those post-petition expenses will be entitled to administrative expense status. 11 U.S.C. §§503(b) and 364(a). The Debtor has $138,000.00 in the bank, and less than $100,000.00 in hard assets (exclusive of flight manuals). (Transcript page 64). Without substantial collections or infusions from third parties, the Debtor is administratively insolvent and will be unable to present a confirmable Chapter 11 plan. The Debtor's lack of assets and operating capital make its reorganization extremely unlikely.

The Debtor's president testified that without the intervention of Tower, the Debtor will not be able to reorganize. Tower's proposals have consistently afforded Tower what is virtually a unilateral right to walk away from the purchase of Key without incurring any significant liability to Key or its creditors. Tower's approach to the purchase of Key makes the chances of a reorganization through intervention by Tower extremely remote.

Although rehabilitation of this Debtor is greatly to be desired, I find that Movant has established, by the great weight of the evidence, that cause exists to convert this case to a case under Chapter 7. In accordance with the language of the Code I find specifically that the Debtor has demonstrated an inability to effectuate to plan; that the period of time during which the case has been pending and the automatic stay has protected the Debtor from certain actions by its creditors has unreasonably delayed their assertion of state law remedies and that they have been prejudiced through the accrual of continuing losses which have resulted in a diminution of the estate. As a result, it would be insupportable if this case were not immediately converted.[4]

Finally, independent "cause" clearly exists for converting this case to a case under Chapter 7 of the Code. It appears that Key may have significant preferential or fraudulent transfer claims against SAG or third parties who are insiders, or who received transfers which benefitted insiders. Those same insiders negotiated the sale of SAG's Key stock to Tower. SAG will ostensibly receive nothing from the sale. Yet SAG strongly supported the proposed sale at the September 30th hearing. The testimony of Tower's principal, Zev Melamid, establishes that Tower will not pursue SAG or its principals or related transferees.

Clearly, the goals of SAG, the sole shareholder of Key, are inconsistent with the best interests of creditors and the estate. This conflict of interest constitutes independent cause for conversion of this case to a case under Chapter 7 of the Code where a trustee can scrutinize and collect insider transfers. Matter of Fiesta Homes of Georgia, Inc., 125 B.R. 321, 325 (Bankr. S.D.Ga. 1990), *citing*: In re Graf Bros., Inc., 19 B.R. 269 (Bankr. Me. 1982). *See also* In re L.S. Good & Co., 8 B.R. 312 (Bankr.N.D.W.Va. 1980) (appointing Chapter 11 trustee due to potential conflicts of interest between management and the estate); In re William H. Vaughan & Co., Inc., 40 B.R. 524 (Bankr. E.D.Pa. 1984) (appointing Chapter 11 trustee due to debtor's failure to commence proceeds for avoidance of transfer to its president); In re Nautilus of New Mexico, Inc., 83 B.R. 784 (Bankr. N.M. 1988) (concluding that co-owner president's conflict of interest made him incapable of dealing with debtor as a fiduciary and appointing Chapter 11 trustee).

ORDER

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than reasons authorizing it to terminate" then Tower's liability would be limited to the funds it had made available to the debtor-in-possession. Clearly this is an impermissible, strongarm provision limiting Tower's damages in the event that it wrongfully breaches the contract.

[3] Even the most recent purchase proposal by Tower would have given Tower the benefit of income from operations and committed the Debtor to pay up to $32,000.00 during the period October 1 to December 31, 1993. (Transcript page 45).

[4] It should be noted that while the Code ordinarily contemplates an immediate liquidation, if there is any ability to continue the operation of this business for a limited period of time in order that the trustee might attempt to sell the company or any of its assets, a Chapter 7 trustee has the authority to do so pursuant to 11 U.S.C. Section 721.

Pursuant to the foregoing Findings of Fact and Conclusions of Law, IT IS THE ORDER OF THIS COURT that this case is converted immediately to a case under Chapter 7 of the Bankruptcy Code and the United States Trustee is directed to appoint a Chapter 7 case trustee instanter.

/s/ Lamar W. Davis, Jr.
Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia
This 5th day of October, 1993.